COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

USGEN NEW ENGLAND, INC.	)	
NEW ENGLAND POWER COMPANY	)	DOCKET NO. _97-94_
MASSACHUSETTS ELECTRIC COMPANY	)	
NANTUCKET ELECTRIC COMPANY	)	

DIRECT TESTIMONY

OF

MICHAEL E. JESANIS

COMMONWEALTH OF MASSACHUSETTS
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INTRODUCTION

Q. Please state your name and business address.

A. Michael E. Jesanis, 25 Research Drive, Westborough, Massachusetts.

Q. By whom are you employed and what is your position?

A. I am Vice President and Treasurer of New England Electric System ("NEES"). I am also Treasurer of New England Power Company ("NEP"), Massachusetts Electric Company ("Mass. Electric"), and New England Power Service Company ("NEPSCO").

Q. Please summarize your professional and educational background.

A. I joined the NEES companies in 1983 as a financial analyst and was elected Treasurer of NEES in 1992. I was elected a Vice President of NEES effective January 1, 1997. I hold bachelor's and master's degrees in mathematics from Clarkson College of Technology and a masters of business administration from the Wharton School at the University of Pennsylvania.

PURPOSE OF TESTIMONY

Q. Please describe the purpose of your testimony.

A. On August 5, 1997, NEP and The Narragansett Electric Company (collectively, the "NEES Companies") executed agreements with USGen New England, Inc. ("USGenNE"),[1/] an indirect subsidiary of PG&E Corporation ("PG&E Corp.") for the sale of substantially all of the NEES Companies' non-nuclear generating business. That sale requires certain approvals from this Department. The purpose of my testimony is to summarize this filing which seeks these approvals, to introduce the other witnesses, to describe the terms and conditions of the proposed sale, to describe the benefits to be realized by customers and to describe the process used to obtain those benefits.

SUMMARY OF FILING

Q. Please summarize the nature of this filing and the supporting testimony of the other witnesses.

A. The implementation of the Divestiture Transaction presented in this filing requires approval. NEP is also requesting financing authority, and Mass. Electric and Nantucket Electric Company ("Nantucket") are seeking to modify their tariffs. In addition to my testimony, this filing is supported by the following witnesses:

[1/] USGen New England, Inc. is the new name of the acquiring company, which is referred to as USGen Acquisition Corporation in the original transaction contracts.

- Mr. Thomas W. Widener, a director with the investment banking firm of Merrill Lynch, provides testimony that describes the process the NEES Companies used to obtain a fair value for their generating business. Merrill Lynch and Mr. Widener were key consultants on the transaction.
- Mr. Paul Levy, Adjunct Professor of Environmental Policy at the Massachusetts Institute of Technology and former Chairman of the Department, evaluates the sale for its compliance with the Department's goals for the divestiture process and for its consistency with the public interest.
- Ms. Jennifer L. Kenney, Principal Financial Analyst for NEPSCO, calculates the impact of the sale on NEP's Contract Termination Charges and supports the economic benefits to Mass. Electric and Nantucket.
- Mr. Peter T. Zschokke, Manager of Retail Rates, supports the retail rates for Mass. Electric and Nantucket to implement the settlement.
- Mr. John G. Cochrane, Vice President and Director of Corporate Finance for NEPSCO, describes the financing requirements related to NEP's performance of its obligations to USGenNE.

As evidenced by the summary, our filing is designed to be comprehensive. It addresses substantially all elements of the transaction as to which Department approval is a condition to consummation of the sale, including the arrangements, contracts, and rates that will need to be in place upon completion of the transaction.

ROLE IN DIVESTITURE

Q. Please describe your role in the proposed sale.

A. I have overall executive responsibility for matters relating to the sale of the NEES Companies' generating business. In that role, I led our efforts to develop a process which would obtain a fair value for our non-nuclear generating business. I also led the team that negotiated the various agreements with USGenNE.

SUMMARY OF TESTIMONY

Q. Please summarize your testimony.

A. The NEES Companies propose to sell substantially all of their 4000 MW non-nuclear generating business to USGenNE for $1.59 billion plus other consideration. In addition, USGenNE will acquire NEP's rights to purchase approximately 1,100 MW of power from other utilities and non-utility generators. If approved, the sale will allow NEP to mitigate over $2 billion of stranded costs which otherwise would have been charged to customers under the settlement agreement reached with various Massachusetts parties and approved by the Department in Docket 96-25 (the "Massachusetts Settlement"). As a result of the

Massachusetts Settlement and the mitigation of stranded costs produced by the divestiture, retail customers of Mass. Electric will realize rate reductions of 14 to 18 percent on average off of current rates. In addition, by selling its generating assets, NEP will essentially become a transmission company. This separation of generation from transmission will aid the development of bulk electric competitive markets, which should further contribute to long-term savings for customers.

REASON FOR SALE

Q. Why are the NEES Companies selling their non-nuclear generating business?

A. The NEES Companies are selling their non-nuclear generating business to comply with the terms of the Massachusetts Settlement among NEP, its Massachusetts distribution affiliates (Massachusetts Electric and Nantucket Electric), the Massachusetts Attorney General, the Massachusetts Division of Energy Resources, and numerous other consumer, competitor, and environmental groups. The Massachusetts Settlement was approved by the Department in February and July 1997 and is currently pending before the Federal Energy Regulatory Commission.

Q. Please describe the events which led to the Massachusetts Settlement.

A. Over the past few years, the three states served by NEES distribution companies have, through a variety of regulatory and legislative actions, established clear public policies that customers of electric utilities in those states should be provided the opportunity to choose their electric supplier. In Rhode Island, the Utility Restructuring Act of 1996 was enacted to provide all customers with the right to choose their electric supplier. Large customers in Rhode Island gained the right to choose on July 1, 1997 and the balance will gain the right to choose during 1998. In New Hampshire, the legislature created pilot programs allowing three percent of that state's customers the right to choose, and enacted HB 1392 that provides for choice for all retail customers during 1998. In Massachusetts, the Department issued policy statements in 1995 and 1996, establishing January 1, 1998 as a target date for allowing electric customers in that state to choose their supplier.

NEES has supported these public policies and has dedicated substantial efforts to assure that customer choice is implemented in a way that benefits consumers while protecting the interests of other constituencies, such as investors, employees and the communities which host generating facilities. During the debate over how to implement retail choice, two issues arose which affected the NEES Companies' decision to sell their generating business. First, aside from the general debate as to whether utilities should be allowed to recover the costs of past commitments whose value might decline if customers were provided the opportunity to choose their supplier (so called "stranded costs"), there was substantial discussion as to how such stranded costs should be measured. In other words, if stranded costs represent the difference between the cost of past commitments and the value of those commitments in an open market environment, how should the value of those commitments be measured? In addition, there was substantial discussion over the development of truly competitive generation markets and whether generating plants and transmission and distribution systems should have separate owners.

In October, 1996, the efforts of NEES led to the ground-breaking Massachusetts Settlement. The Massachusetts Settlement provides for customer choice of supplier by 1998 with guarantees of 10 percent rate reductions together with opportunities for greater reductions. To compensate investors for their past commitments, the Massachusetts Settlement also provides for the recovery of stranded costs through a Contract Termination Charge. Moreover, in order to value the generating assets properly, and to provide the best opportunity for competitive markets to develop, the NEES Companies agreed to divest their non-nuclear generating business and to endeavor to divest their nuclear interests.

PROCESS USED TO CARRY OUT DIVESTITURE

Q. How did the NEES Companies proceed to meet their divestiture commitment?

A. Since October 1996, the NEES Companies have aggressively moved to market their generating business in a manner which would provide the greatest mitigation of Contract Termination Charges to be charged to customers. The NEES Companies assembled a team to coordinate the divestiture efforts and retained Merrill Lynch, a leading investment banking firm, to advise NEES Companies on how to structure a sale to meet its mitigation objective. The NEES Companies also undertook substantial efforts to determine the precise separation between the generating assets to be sold and the transmission assets to be retained.

Together with Merrill Lynch, the NEES Companies solicited interest from companies around the globe that might be interested in entering or expanding their generating business. The NEES Companies prepared and distributed an Information Memorandum describing the business for sale, opened a data room and conducted plant visits -- a process through which prospective bidders could obtain information about the NEES Companies' business in a complete, efficient and even-handed manner.

In March 1997, the NEES Companies received preliminary non-binding proposals from 25 companies for all or a portion of their non-nuclear generating business. From these proposals, the NEES Companies, working closely with Merrill Lynch, selected a smaller group of bidders that were then provided an opportunity to conduct additional due diligence and to make binding proposals for all or predetermined portions of the NEES Companies non-nuclear generating business.

In July 1997, the NEES Companies received firm proposals from the selected group. Based on USGenNE's proposal and subsequent negotiations with USGenNE, the NEES Companies concluded that consummating an agreement with USGenNE was likely to lead to the greatest cost mitigation and resulting customer benefits. As a result, the NEES Companies decided to enter into exclusive negotiations with USGenNE. Those negotiations concluded with the execution of a definitive Asset Purchase Agreement among NEP, Narragansett and USGenNE on August 5, 1997. A copy of the Asset Purchase Agreement is provided in Book 1 of the Contract Documents Relating to the Sale.

TERMS OF THE SALE

Q. Please summarize the terms of the proposed sale to USGenNE.

A. Pursuant to the Asset Purchase Agreement, NEP will sell to USGenNE approximately 4,000 MW of fossil and hydroelectric generating stations in Massachusetts, Rhode Island, New Hampshire and Vermont. Narragansett will sell USGenNE its ten percent interest in the Manchester Street Station in Providence, Rhode Island. The balance of Manchester Street is owned by NEP and is also being sold to USGenNE. NEP will also sell to

USGenNE 100 percent of the stock of Narragansett Energy Resources Corporation (NERC), a 20 percent general partner in the Ocean State Power I and II projects. The NERC stock is currently owned by NEES. However, NEES intends to transfer the NERC stock to NEP prior to the closing at net book value for resale by NEP to USGenNE.

USGenNE will pay the NEES Companies $1.59 billion, of which $225 million is contingent on the timely introduction of retail competition in New England. Of this amount, Narragansett will receive book value for its interest in the Manchester Street station, with NEP receiving the balance. USGenNE will also pay NEP $85 million to cover the cost of early retirement, severance and retraining programs for employees affected by the sale and by the introduction of retail customer choice. USGenNE will further reimburse NEP for the cost of fuel and materials and supplies inventories at the closing, and for the cost of certain capital improvements and major maintenance expenditures that may be made prior to the closing. The Asset Purchase Agreement also is summarized in an Attachment to the Petition.

Q. Please describe the contingent portion of the purchase price.

A. During negotiations, USGenNE expressed its belief that the value of the NEES Companies' generating assets is highest in a market in which USGenNE has the opportunity to market electric products to the broadest possible customer base. As a result of USGenNE's concerns, the NEES Companies and USGenNE negotiated a provision by which $225 million of the $1.59 billion purchase price would be contingent upon the broad implementation of retail choice in the New England region (the balance of the purchase price of $1.365 billion is uncontingent with respect to implementation of retail choice). Specifically, the full contingent amount is paid by USGenNE to NEP if retail choice is available to customers representing 89 percent of 1995 kwh sales of Massachusetts investor-owned utilities or 50 percent of kwh sales by all New England utilities by January 1, 1999. After January 1, 1999, the contingent purchase price would be reduced on a daily basis depending on the date the retail choice standard described above is met. Under the Asset Purchase Agreement, the contingent payment drops to $150 million by the end of 1999, to $100 million by the end of 2000, to $50 million by the end of 2001 and to zero at the end of 2002.

To the extent that the retail choice standard was met other than through the passage of legislation, the amount of the payment would be the same; however, the date of payment will be delayed two years to assure that retail choice was continuously in effect.

Q. Please describe the obligations that USGenNE will be assuming when it purchases NEES Companies' non-nuclear generating business.

A. USGenNE will be assuming most obligations related to the non-nuclear generating business. Among these obligations are contracts with fuel and fuel transportation suppliers, property tax treaties with host communities, certain collective bargaining agreements and the cost of making environmental improvements at NEP's generating stations as required by the settlement.

In addition, NEP and USGenNE have entered into several ancillary agreements. Under the "IPP Contracts Transfer Agreement",[2/] USGenNE will purchase NEP's entitlements in approximately 1100 MW of power procured by NEP under long-term contracts with utility and non-utility generators, which have terms expiring as late as 2019. Under the IPP Contracts Transfer Agreement, NEP will make a fixed contribution of between $12.5 and $14.2 million per month toward the cost of that above-market power, with USGenNE reimbursing NEP for the balance of the costs. NEP's contribution will end in January 2008. A copy of the IPP Contracts Transfer Agreement is provided in Book 5 of the Contract Documents Relating to the Sale and is summarized in an Attachment to the Petition.

[2/] The "IPP Contracts Transfer Agreement" is actually entitled "PPA Transfer Agreement," but is referred to as the "IPP Contracts Transfer Agreement" to better describe its purpose in this filing.

Under a series of contracts referred to in this filing as the "Wholesale Customer Support Agreements",[3/] USGenNE will sell to NEP such capacity and energy as is required to meet NEP's obligations under certain power sales agreements between NEP and various wholesale customers. The pricing of USGenNE's sale to NEP will mirror the pricing under the underlying power sales agreements. The Wholesale Customer Support Agreements are provided in Book 5 of the Contract Documents Relating to the Sale and are summarized in an Attachment to the Petition.

USGenNE is also undertaking obligations to provide capacity and energy to NEP's distribution affiliates. Under "Wholesale Standard Offer Service Agreements", USGenNE agrees to provide the distribution affiliates with all-requirements service until such time as the retail customers of those affiliates have the right to choose an alternative supplier. After such time, USGenNE will provide the distribution affiliates with wholesale power supplies necessary to allow those affiliates to provide their customers with Standard Offer Service. The prices for Wholesale Standard Offer Service were negotiated as part of the Massachusetts Settlement and the Rhode Island Settlement. Under the Settlements, these power supplies will be subject to a wholesale price auction in which other suppliers will be allowed to displace USGenNE as the supplier by bidding a discount from Wholesale

[3/] The Wholesale Customer Support Agreements are actually entitled "PSA Performance Support Agreements," but are referred to as the "Wholesale Customer Support Agreements" to better describe its purpose in this filing.

Standard Offer prices. Twelve wholesale suppliers have qualified to participate in this auction. Copies of the Wholesale Standard Offer Service Agreements are provided in Book 5 of the Contract Documents Relating to the Sale and are summarized in an Attachment to the Petition.

To support USGenNE's obligation to provide Standard Offer Service, NEP has agreed to provide USGenNE with an option to purchase capacity and energy from NEP's entitlements in three operating nuclear generating stations ("Nuclear Wholesale Power Agreement").[4/] The option extends through the period that USGenNE is providing Standard Offer Service, unless NEP disposes of the nuclear entitlements to another party. A copy of the Nuclear Wholesale Power Agreement is provided in Book 5 of the Contract Documents Relating to the Sale and is summarized in an Attachment to the Petition.

Finally, USGenNE and NEP have entered into a Continuing Site/Interconnection Agreement. The Continuing Site/Interconnection Agreement governs the terms by which NEP will interconnect USGenNE to its transmission system and by which NEP and USGenNE will have access and provide services to each other's facilities. A copy of the

[4/] The "Nuclear Wholesale Power Agreement" is actually entitled "Wholesale Sale Agreement" but is referred to as the "Nuclear Wholesale Power Agreement" to better describe the contract for this filing.

Continuing Site/Interconnection Agreement is provided in Book 4 of the Contract Documents Relating to the Sale and is summarized in an Attachment to the Petition.

The liabilities that will not be assumed by USGenNE include debt obligations of either seller, obligations to pay trade creditors for products and services delivered prior to the closing, certain liabilities related to workers' compensation or third party injuries, and liability for the cost of remediating remote sites which may contain hazardous materials disposed prior to the closing.

Q. Is USGenNE purchasing all of the assets which NEP committed to sell in the Massachusetts Settlement?

A. USGenNE will be purchasing substantially all of the assets which NEP committed to sell in the Massachusetts Settlement. USGenNE will not be purchasing NEP's approximately 57 MW interest in the Wyman 4 generating station, majority-owned and operated by Central Maine Power Company ("CMP"). CMP has announced its intention to sell its generating business, including Wyman 4, and NEP is working with CMP to sell its interest to the buyer of CMP's Wyman 4 interest. In addition, NEP is retaining diesel units of about 20 megawatts in Gloucester, Massachusetts and an additional 19 megawatts on Nantucket. These diesel units are necessary to maintain reliability for local area service.

Finally, NEP is removing from service and selling 5.5 megawatts of diesel capacity in Newburyport to third parties.

NEP also will be separately conducting a sale of certain land holdings not required in its transmission business. NEP's affiliate, New England Energy Incorporated, is separately conducting a sale of its oil and gas properties. Finally, NEP has agreed to endeavor to sell its interests in operating nuclear generating stations. NEP is in the process of developing a plan to determine market interest in its operating nuclear assets.

OTHER OPTIONS CONSIDERED

Q. In the proposed sale, the NEES Companies are selling substantially all of their non-nuclear generating business to a single buyer. What other options did the NEES Companies consider for divesting their assets?

A. The objective of the NEES Companies was to achieve the highest level of stranded cost mitigation for their customers. The agreement with USGenNE meets this objective. However, the NEES Companies did consider and pursue other options for meeting this objective. First, prior to deciding to sell the business, the NEES Companies considered a spinoff of the business to shareholders of NEES. In a spinoff transaction, shareholders of NEES would receive shares in a new company formed specifically to own the NEES Companies' non-nuclear generating assets. A spinoff could have established an independent value of the generating assets (through the value of the stock as it traded in stock markets) and would have separated generation from transmission and distribution assets. For several reasons, including the fact that utility investors might be averse to owning stock in a merchant generating company, the NEES Companies concluded that a spinoff was unlikely to maximize the mitigation opportunities for customers compared to an outright sale.

Second, during the sale process itself, the NEES Companies used the marketplace to determine whether the value of the business was maximized by selling it as a whole to a single buyer or in parts to multiple buyers. Selling the generating business as a whole would allow purchasers to take advantage of substantial synergies (such as in fuel and other purchasing, maintenance, and scheduling activities) which we believe exist in a single business, while selling it in parts would allow a greater number of purchasers, including smaller companies wishing to make smaller capital commitments, to participate in the process. To test for value under these scenarios, prospective purchasers were invited to submit proposals for the business as a whole or for one or more of six individual business units formed to facilitate the sale. Four of the business units each consisted of a single major generating station, a fifth consisted of NEP’s conventional hydroelectric stations, and a sixth consisted of NEP’s rights in purchased power contracts.

During the first round of bidding, the NEES Companies received forty-one proposals from twenty-five companies. Nearly two-thirds of these proposals were for individual business units or groups of business units. However, from the first round bids, the NEES Companies were able to conclude that selling the business as either a whole or in significant parts was likely to maximize the value of the business. Therefore, in the final bids, bidders were restricted to submitting bids for the business as a whole or for two business units: a business unit comprised of the pumped storage and conventional hydroelectric assets, and a business unit comprised of the fossil-fuel assets and the purchased power contracts. Based on the final bids received, no sale of the business as separate parts would have realized more value for customers than the agreement reached with USGenNE.

FINANCING ISSUES

Q. Does NEP require approval of a financing plan to implement the proposed sale?

A. Yes, but in a much more limited manner than was contemplated at the time of the Department was considering the Massachusetts Settlement. At the time NEP originally entered into the Massachusetts Settlement, NEP was concerned that the proceeds from the sale might be inadequate to provide for the retirement or refinancing of NEP’s first mortgage bonds. Given that the proceeds, after the payment of transaction costs and income taxes, are sufficient to provide for the retirement or refinancing of NEP's first mortgage bonds, action from the Department is necessary solely to allow NEP to fulfill its obligations to USGenNE under the IPP Contracts Transfer Agreement.

Q. Please describe the specific terms of the IPP Contracts Transfer Agreement which require approval of a financing plan?

A. The IPP Contracts Transfer Agreement is designed to transfer NEP's rights and obligations (except for the fixed contributions by NEP described above) to USGenNE under various power purchase agreements while leaving NEP as the primary obligor to the underlying power sellers. By leaving NEP as the primary obligor, no consent of the power sellers is necessary to consummate the sale of NEP's generating business. However, NEP and USGen are obligated to use reasonable efforts to gain a direct assignment of the contractual obligations to USGenNE and a release of NEP from its obligations. In the event that NEP is released from all or a portion of any obligation, NEP with the consent of USGenNE, will make a Trigger Payment to the power supplier or as otherwise directed by USGenNE. The Trigger Payment is a lump sum equal to the present value of the fixed contributions allocated to the obligation being released.

Q. How will NEP fund the lump sum?

A. The IPP Contracts Transfer Agreement requires NEP to use reasonable efforts to maintain regulatory authority to raise $100 million through the issuance of long-term securities. To the extent that the amount of financing necessary to fund the lump sum exceeds $100 million, NEP would seek future authority from the Department to raise the additional funds through the issuance of long-term securities.

Q. Must NEP pay the lump sum demand under all circumstances?

A. No. NEP must make the payment to USGenNE only if NEP is reasonably satisfied that the payment would be currently deductible for Federal and state income tax purposes and that the deduction can be fully utilized in NEP's tax returns. In addition, the payment may be deferred if NEP does not have regulatory approvals for the financings reasonably required to finance the payment.

Q. What happens if NEP does not make the lump sum payment demanded by USGenNE?

A. In the event NEP defers the payment, NEP will continue to make the fixed contributions which were the subject of the lump sum demand. However, in order to provide additional security for USGenNE, NEP has agreed to provide USGenNE with a security interest in such portion of the Contract Termination Charges payable by Mass. Electric and

Narragansett as is equal to the fixed contributions which were the subject of the lump sum demand. Through this filing, NEP is requesting Department approval to grant such a security interest to USGenNE.

Q. Besides the $100 million of authority you are requesting in this filing, does NEP anticipate requesting any additional financing authority?

A. Yes. NEP is developing a plan which, if implemented, would have the goal of substantially reducing the financing costs associated with its remaining stranded costs. When completed, that plan will be the subject of a separate filing with the Department.

BENEFITS TO CUSTOMERS

Q. What are the rate benefits to NEP's retail affiliates?

A. If the sale is approved, it will result in a residual value credit against NEP's stranded costs, allowing NEP to mitigate over $2 billion of stranded costs which otherwise would have been charged to NEP's retail electric distribution affiliates under the wholesale rate settlements pending before the FERC. The calculation of the residual value credit to stranded costs is more fully explained in the testimony of Jennifer L. Kenney.

Q. What are the corresponding benefits to retail distribution customers?

A. Assuming no holdback of the purchase price, retail customers of Massachusetts Electric will realize, on average, rate reductions of 18 percent from current rates. (See the Testimony of Peter T. Zschokke). Moreover, this level of savings applies to those customers who do not take advantage of the open market and, instead, remain on Standard Offer Service. Customers who choose to go to the open retail market will have the opportunity to reap even more savings from competitive pricing in the retail market.

Q. What other benefits arise from this sale?

A. By selling its generating assets, NEP will essentially become a transmission company. This separation of generation from transmission will assist the development of competitive power markets in New England, further contributing to long-term savings for customers.

Q. Does this conclude your testimony?

A. Yes. It does.